SUMMARY OF THE EARLY-OUT RETIREMENT PROPOSAL FOR STATE EMPLOYEES

by Joe Carrasco, Fiscal Analyst

On February 7, 2002, in the release of the fiscal year (FY) 2002-03 Executive Budget Recommendation, Governor Engler proposed an early-out retirement plan for State employees. That proposal is now contained in House Bill (HB) 5732, which the Michigan House of Representatives passed on February 28, 2002. The bill containing the Governor's proposal for an early-out retirement plan also includes several changes aside from the early-out provisions. Following is a summary of the highlights of House-passed HB 5732.

Current Law Provisions

Members of the State Employees Retirement System's (SERS's) defined benefit plan are entitled to retire with full retirement benefits upon meeting the age and service requirements. Currently, those requirement are:

- Age 60 with 10 or more years of credited service (or five years in certain circumstances); or,
- Age 55 with at least 30 years of credited service; or Age 55 with at least 15 but less than 30 years of credited service; however, the pensions for these early retirees is permanently reduced by 0.5% for each month a member is less than age 60.

A pension under current law is calculated by multiplying 1.5% by the final average compensation (FAC), times the years of credited service. The FAC is determined by using the three consecutive years of service that return the highest average.

Proposed Early-Out Provisions

House Bill 5732 proposes an early out provision for most members of SERS. To be eligible, a member would have to have been employed by the State (or be on layoff status) for the preceding six-month period ending on the effective date of his or her retirement. Members who would be eligible for this early-out retirement plan are classified Civil Service employees, unclassified Civil Service employees, employees of the judicial and legislative branches who are not judges or legislators, employees of the Governor's office, and employees working in covered positions who are otherwise not eligible for a supplemental early retirement for covered employees under current law. Members who would be exempt from taking an early-out retirement under this proposal are those working as conservation officers and those working in covered positions who do qualify for a supplemental early retirement for covered employees as specified. (Covered employees are generally those working within the confines of a secure correctional facility.)

To qualify for an early-out retirement under HB 5732, a member would have to have a combined age and length of credited service that equaled at least 80 ("80 and out") as of November 1, 2002, or on the effective date of retirement, whichever would be earlier. There would be no minimum age requirement so long as the member met the 80 points. Members meeting these requirements would receive full retirement benefits the same as traditional retirees under current law, with one exception.

Members choosing to retire early under this proposal would receive an enhanced multiplier of 1.75%, rather than the 1.5% under current law as mentioned above. Thus, the retirement calculation for an employee taking an early retirement under this proposal would be:

1.75% times FAC times years of credited service

The window period for members to file for an early-out retirement would be relatively short. Members would have to file an application for retirement with the Office of Retirement Services between April 1 and April 30, 2002, and state a retirement date between July 1, 2002, and November 1, 2002. Members filing an application also would be able to withdraw that application for any reason until May 15, 2002; after that date, the application would be irrevocable.

Finally, members of SERS who transferred from the defined benefit plan to the defined contribution plan and met the "80 and out" requirements also would be eligible for this early-out retirement plan. However, these members would receive a benefit based only on 0.25% of FAC times years of credited service.

Extension of Retirement Date and Lump Sum Payments
Individuals eligible for the early-out retirement plan would be able to extend their retirement date up to 15 months (no later than February 1, 2004) from the original dates set forth in the proposed legislation. Members could extend their retirement dates provided that an extension was requested by their department director or designated by the Legislature or the judiciary. Requests for extensions for executive branch employees would have to be submitted to, and approved by, the Office of the State Employer and the State Budget Office by May 31, 2002. Legislative and judicial employees would have to submit their requests to the Office of Retirement Services by May 1, 2002; however; approval would be granted by legislative leaders or the chief justice, as applicable.

House Bill 5732 also would provide for the payment of both accrued sick leave and accrued annual leave. Accumulated sick leave would be paid in monthly installments over a period of five years, while accrued annual leave would be paid in a lump sum on or after October 1, 2002. The bill specifies that payments received under this provision could not be used for the purchase of service credit.

In addition to the early-out retirement plan provisions, HB 5732 contains provisions not related to the early-out retirement plan. These changes are as follows:

- **Health Advance Funding Subaccount** - The bill would create the Health Advance Funding Subaccount for the purpose of receiving deposits in years when the assets for normal retirement benefits are funded at 100% or more. In years when normal costs are fully funded, employer contributions could be deposited into the new subaccount. Funds from the subaccount could not be spent until the actuarial liability for health benefits was fully funded. Also, the Department of Management and Budget would be permitted to transfer amounts from the Health Advance Funding Subaccount to the employer's accumulation fund (the fund set aside for the pensions of future retirees) to cover any underfunding that might arise for normal retirement costs.

- **Duty and Non-Duty Disability Pensions** - The bill would establish a deadline for application for disability pensions of 12 months after the employee had separated from State service. A member could file an appeal to the retirement board to allow up to 24 months for application if "good cause" were determined. Current practice has been to allow up to 24 months from the date of separation from State service; however, there is no statutory provision for doing so.

- **Medical Examinations** - Currently, disability retirees under age 60 are required to undergo a medical examination to determine disability once per year for the first five years of retirement, and at least once every three years thereafter. House Bill 5732 would eliminate this requirement and specify instead that the retirement board could require a person to be examined at any time but not more than once per calendar year. Also, under current law, a disability retiree who is found to be physically able and capable of returning to work must be restored to State employment and the disability retirement allowance ended. This bill, instead simply would end disability retirement allowance benefits after six months of a finding that the retiree is physically capable of returning to work.

Fiscal Impact
Current Department of Management and Budget estimates indicate that approximately 8,800 State employees would be eligible to retire under this early-out plan, with an average annual salary of $68,600. Of those eligible, it is estimated that 5,300 would take advantage of this option and retire early. The Governor's plan calls for a replacement ratio of one to four, meaning that for every four employees who retired, only one eventually would be replaced, on average. Thus, all cost estimates take these factors into account.

Based on the salaries and the number of employees anticipated to retire early under this proposal, the State would realize an annual saving of $361 million. After the subtraction of all costs, such as health insurance, accumulated sick leave, and accumulated annual leave, the replacement of one in four employees, and the increase in pension liabilities for these new retirees, the State would realize a net GF/GP savings of $58 million annually.

As mentioned at the beginning of this article, HB 5732 has been passed by the Michigan House of Representatives. The next action will take place before the Senate Appropriations Committee. If approved by the Committee, the bill would move to the full Senate for passage. In order for the proposed window period for making an early retirement decision to begin, the bill would have to be signed into law by March 31, 2002.